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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

PUBLIC SERVICE COMPANY OF INDIANA, INC.,
Petitioner,

v.

INTERSTATE COMMERCE COMMISSION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY AND SUPPLEMENTAL BRIEF OF PETITIONER PUBLIC SERVICE COMPANY OF INDIANA, INC.

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STATEMENT

The opinion of the court of appeals (App. 1a-34a) is reported at 749 F.2d 753. The petition for a writ of certiorari was filed on April 29, 1985. The brief in opposition of respondent Seaboard System Railroad, Inc., was filed on June 20, 1985. The brief for the Federal Respondents in Opposition was filed September 25, 1985.

SUMMARY OF REPLY ARGUMENT

The Staggers Rail Act of 1980 did not abrogate the preexisting requirement of the Interstate Commerce Act that rail rates subject to the jurisdiction of the ICC or

the states be reasonable. Neither did it preempt the power of state regulatory agencies, to determine, under appropriate strictures, the reasonableness of an intrastate rail rate. The modified appellate procedures of Section 214 of the Staggers Act (codified at 49 U.S.C. 11501) were intended to insure federal-state uniformity and the consistent application of federal standards by the state regulatory agencies. The defined role of the ICC therefore, is one of review of state decisions determining the lawfulness of an intrastate rail rate. The ICC has no authority to set aside a state decision unless it finds—properly—that the state agency has violated federal standards or procedures. (49 U.S.C. 11501 (c)). Thus, while it is conceded that the burden of demonstrating rate unreasonableness was upon the shipper, petitioner here, in the state proceeding, the issue before the ICC upon statutory review is simply whether the state commission violated a specific federal standard.

Contrary to the assertions of respondents that the questions presented for review by petitioner are "fact bound", the pleadings now make it abundantly clear that one paramount question of law lies at the heart of this action. Did the Public Service Commission of Indiana (PSCI) violate a federal standard of railroad revenue adequacy in prescribing a rate equal to the Staggers Act jurisdictional threshold where that rate substantially exceeded the railroad's full costs of service including return on capital as determined by the ICC? Clearly, it did not do so, as confirmed by the recent decision of the ICC in Docket No. 38412S, *Allied Chemical Corporation, et al.* v. *Ann Arbor Railroad System et al.* (decided June 10, 1985, not printed).

ARGUMENT

I. It Is Now Undisputed That The Indiana Commission Did Not Violate A Federal Standard In Predicating It's Rate Prescription Upon Railroad Costs Of Service

Extensive evidence as to the specific costs of the Louisville & Nashville Railroad Company (now merged into respondent, Seaboard System Railroad, Inc.) incurred in handling petitioner's coal traffic was presented by both parties. PSCI accepted petitioners' cost evidence as the more reliable. It found a maximum reasonable rate to be 55.8 cents per ton, equal to L&N's full costs of service (variable plus fixed costs) including profit at the current cost of capital level fixed by the ICC. PSCI, however, prescribed a rate of 65 cents per ton equal to the then applicable jurisdictional level, thus providing for a substantial measure of differential or demand-based pricing.[1] The *fact* of differential pricing by the Indiana Commission is, therefore, undisputed. The *magnitude* of the differential pricing allowed by PSCI cannot lawfully be questioned unless it violated some federal standard, which is not here the case.

It is now conceded that PSCI's cost-based approach to ratemaking was proper under the Interstate Commerce Act. The Federal respondents now acknowledge, consistent with the discussion in the petition (Pet. 9-12), that "[c]osts have always been and will continue to be, a factor in rate reasonableness determinations". (Br.9)

Contrary to the contention of the Federal respondents in this context (Br.9) PSCI did not end its analysis with the determination of either variable or full costs of service. It took cognizance of the Staggers Act jurisdictional threshold and prescribed a rate of 65 cents per ton, approximately 16.5 percent above full costs. By

[1] By definition differential pricing is pricing above full costs. The economic rationale for such pricing is accurately stated in Footnote 8 at page 6 of the Brief for Federal Respondents.

way of contrast, the "appropriate rate" authorized by the ICC is in no sense a reflection of costs of service, even as restated in the ICC's decision. Thus, it is the ICC, not PSCI that has failed to accord appropriate weight to costs as "a factor in rate reasonableness determinations.

II. The Prescription Of A Rate At The Jurisdictional Threshold Did Not Violate Any Federal Standard

The Federal respondents point out that the Indiana Commission, in setting the rate at the jurisdictional threshold level "prescribed . . . the lowest possible rate that could be set under the Staggers Act". (Br.4) This element of the PSCI decision loomed large in both the ICC and court of appeals decisions. But, if, as Federal respondents now concede, the 65 cent per ton rate "could be set under the Staggers Act" then, indisputably PSCI did not violate that statute in doing so. This conclusion is confirmed by the statute itself. As the court of appeals noted in its decision (App.24a) a rate at or near the jurisdictional threshold is not presumptively above or *below* a reasonable maximum. 49 U.S.C. 10709(d)(4). It necessarily follows, as the Federal respondents have stated, that a rate as low as the jurisdictional threshold could lawfully be fixed under the Staggers Act.

III. Assuming, *Arguendo*, That The Indiana Commission Was Not Warranted In Finding L&N To Be Inefficient, No Federal Standard Of Revenue Adequacy Was Violated By That Commission

In order to place in clear perspective the exaggerated concepts of the revenue adequacy provision of the statute that lay at the heart of the ICC and court of appeals decisions, this Court is asked to assume *arguendo* that PSCI had insufficient evidence to find L&N inefficient.[2]

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[2] Petitioners, of course, do not so concede. The evidence of inefficiency transcends the simplistic comparison with Southern Railway to which respondents allude. Fundamentally PSCI found that

Under this hypothesis L&N would be assumed to have been revenue inadequate under "honest economical and efficient management". (49 U.S.C. 10704(a)(2). Notwithstanding, as demonstrated in the petition, the Staggers Act requires balanced consideration of railroad revenue adequacy, on the one hand, and, on the other, entitlement of captive shippers, like petitioner here, to protection from excessive monopolistic rates.[3] With other criticisms of the standards applied in the state's decision demonstrated to be unwarranted, the only remaining, indeed the "crucial" violation of a federal standard that has been asserted by both the ICC and the court of appeals is inadequate consideration of the policy of assisting railroads to achieve revenue adequacy.

The concept of revenue adequacy was first articulated in § 205 of the Railroad Revitalization and Regulatory Reform Act of 1976, not in the Staggers Act. Under that provision, as now codified in 49 U.S.C. 10704(a)(2) the ICC is called upon in essence to develop standards for determining adequate revenue levels "under honest, economical and efficient management" and to undertake to assist carriers in attaining such revenue levels. With regard to the former the ICC has made annual cost of capital determinations. As earlier noted, the then current cost of capital was applied by PSCI in developing L&N full costs of service on the subject coal movement. As the court of appeals acknowledged, no further standard of revenue adequacy was provided for guidance of state regulatory agencies. (App.30a). And clearly, the views of the court below notwithstanding, none are discernible in the Staggers Act.

Commissioner Simmons, dissenting from the first decision, and Chairman Taylor from the second, both recognized a lack of ICC-defined federal standards. The

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L&N fixed prices on competitive traffic under differential pricing without any meaningful information as to its costs of service.

[3] See discussion in Petition at pages 8-9 and 13-14.

former recognized that the majority's first decision turned upon alleged failure of the state agency to apply an asserted federal standard of revenue adequacy. (App. 82a). The latter, dissenting from the second decision, pointed out most appropriately that under the statutory scheme of review "Absent inconsistency with federal standards and procedures, the decision by the Indiana Commission must stand". (App.73a).

The decisions of the ICC and the court of appeals are replete with emphasis upon railroad revenue adequacy as the governing factor in maximum rate determinations while the legislative purpose of balanced protection for captive shippers is lost to view. Thus, to illustrate, railroad revenue adequacy is said by the ICC to be a "crucial factor in individual rate cases" (App.47a) and further that ". . . the revenue adequacy mandate of the Staggers Act could not have been more emphatic" (App.50a). To the same effect, the court of appeals in an extensive discussion of this factor viewed it to be the intent of Congress that "revenue adequacy *must* be stressed in ratemaking under the Act". (App. 15a, emphasis in original). The same undue emphasis upon revenue adequacy is reflected in the brief of federal respondents here (e.g.Br.2).

Indisputably the rule of law promulgated by the ICC here is that no rate relief can be accorded to a captive shipper, whatever the rate level, so long as the railroad is revenue inadequate. But the ICC has now disavowed that position.

In Docket No. 38412S, *Allied Chemical Corporation, et al.* v. *Ann Arbor Railroad System et al.*, ICC Administrative Law Judge James E. Hopkins stated "The decision in this proceeding painful as it may be for these complainants, and for other shippers or consignees, revolves essentially on the achievement of revenue adequacy by the defendant rail carriers". (Decision served

February 21, 1984, page 13, not printed). As authority for this conclusion Judge Hopkins cited and quoted from the ICC's second decision herein (reproduced at App. 47a). Judge Hopkins summarized his discussion of the rule of law promulgated by the ICC here, by stating that "Until a carrier is revenue adequate any rate can be unreasonably high". (Page 14).

The ICC recently issued its decision in the *Allied Chemical* case, which it dismissed for lack of jurisdiction. (Decision served June 10, 1985, not printed). It felt constrained to add the following conclusory comments responsive to the earlier findings of Judge Hopkins:

> However, one aspect of the ALJ's Phase 2 initial decision is so glaringly in error that we must comment on it. The ALJ suggested there that no rate on captive traffic (even if it were "1000 percent of variable costs") can be found unreasonable if it is charged by a railroad that the Commission has determined to be revenue inadequate. However, revenue adequacy is not the sole standard for determining the reasonableness of rates and has never been interpreted as such by the Commission. Thus, the fact that a carrier is not revenue adequate does not mean that all of its rates are necessarily reasonable.

In short the ICC now concedes that the statutory scheme permits of finding that a particular rate is unreasonable even if the carrier is revenue inadequate.[4] Hence, the Indiana Commission did not violate any federal standard of revenue adequate in making such a finding, particularly since it is not disputed that the rate fixed by PSCI contributed generously to L&N's overall profits.

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[4] On brief the federal respondents urge deference to the agency's construction of a statute, particularly a new statute. (Br. 12, footnote 13). Such deference must likewise be accorded to the ICC's most recent interpretation in the *Allied Chemical* decision.

CONCLUSION

The issue raised by the L&N's petition to the ICC for review was not whether that agency might reach a different conclusion than did the Indiana Commission as to the level of a maximum reasonable rate but, rather, whether the state agency had violated some federal standard or procedure. Absent such a justifiable condition precedent to the exercise of its jurisdiction, as Chairman Taylor pointed out in his dissenting expression, the ICC lacked authority to substitute its judgment for that of the Indiana Commission. Hence, the validity of the ICC's restatement of costs or its approval of an appropriate rate unwarranted by even that cost restatement is not dispositive unless Indiana violated a federal standard. Clearly, as shown above, that was not the case. The Federal respondents now concede that the state commission could lawfully set the rate that it did under the Staggers Act. The ICC has recently interpreted the same legislation as permitting the prescription of a maximum rate even for a revenue inadequate railroad.

In view of the foregoing this Court should grant a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit.

Respectfully submitted,

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